Nos. 15983 and 15984
Civil

United States Court of Appeals

For the Ninth Circuit

THOMAS M. ROBINSON,
Appellant

v.

WILLIAM G. ELLIOT,
Appellee

THOMAS M. ROBINSON,
Appellant

v.

THOMAS W. ELLIOT AND EVELYN W. ELLIOT,
Appellees

Appeal from the United States District Court for the District of Montana

Appellees' Brief

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SUBJECT INDEX

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STATEMENT OF THE CASE

This appeal presents one question on the merits. The appellant has also raised two procedural questions.

The question on the merits concerns whether the so-called "Lease Agreement and Purchase Option" as supplemented by a "Memorandum Agreement" constitutes a sales agreement of real property resulting in the payments made thereunder being subject to capital gain treatment.

Concerning the procedural questions, one involves Section 44 of the 1939 Internal Revenue Code; the other involves an alleged "fatal variance" between some of the refund claims filed and the allegation contained in the complaints.

We respectfully submit that under the facts and law involved in this case, that the agreement in question constituted a sales agreement rather than a true lease, and that therefore the appellees are entitled to capital gain treatment on the payments received by them and are entitled to the refunds as set forth in the judgments rendered by the Montana District Court and it is further respectfully submitted that the procedural questions raised by the appellant must be decided in favor of the appellees.

We respectfully submit that there was no error committed by the trial court and that the judgments should be affirmed. In this connection it is noted that Rule 52 (a) of the Rules of Civil Procedure provides that the findings of fact of a district court in all actions tried without a jury shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.

STATUTES INVOLVED

1939 Internal Revenue Code:

Sec. 111. Determination of amounts of, and Recognition of Gain or Loss.

(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Sec. 117. Capital Gains and Losses.

* * * * * * * * * *

(b) Deduction From Gross Income. — In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 per centum of the amount of such excess shall be a deduction from gross income. * * * * * *

Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or Business Expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

INTRODUCTION

The statement of facts contained in appellant's brief is incomplete and also contain inaccuracies. Accordingly, we shall review the evidence and the trial court's Findings of Fact somewhat in detail.

The statement of facts relating to the issue on the merits will be set forth and followed by appellees' argument on the merits and thereafter a statement of facts relating to the two procedural questions will be made and followed by appellees' argument thereon.

The evidence in these cases consisted of:

1. The testimony of three witnesses all of whom were witnesses for the appellees. No witnesses testified for the appellant and the appellant did not cross-examine the witnesses for the appellees. (R. 113-150).

2. Stipulations of Facts which were agreed upon and admitted as evidence in both cases (No. 15983, R. 65-73; No. 15984, R. 45-53).

3. A stipulation of Documentary Evidence was agreed upon and admitted as evidence in both cases (No. 15983, R. 65.)

4. Plaintiff's Exhibit No. 1 was stipulated into evidence in both cases. (R. 112).

STATEMENT OF FACTS RELATING TO THE ISSUE ON THE MERITS

Mr. Thomas Elliot, prior to the year 1946, was an officer and the manager and operator of the Flathead Commercial Company, a corporation, at Kalispell, Montana. He ran the business of this company which was engaged in the sale of general merchandise and in the operation of a department store. It had been in business since the 1920's. (No. 15983, R. 81; R. 114, 115).

During 1945, Mr. Thomas Elliot was approached by the F. A. Buttrey Company (hereinafter called Buttrey Co.), a well-known Montana corporation which operates a number of retail department stores. Said company desired to purchase the business of the Flathead Commercial Company. Buttrey Co. had previously discussed such a purchase but serious negotiations were not entered into until July or August of 1945. Late in 1945, Mr. Thomas Elliot decided, principally due to reasons of his health, to sell his store business, that is, the business of the Flathead Commercial Company. Negotiations were carried on in Billings in December of 1945 with representatives of Buttrey Co. and Mr. Thomas Elliot's brother, Mr. William Elliot, and his nephew, Mr. Howard Elliot, were also present. During these negotiations, a final agreement was made for the sale of the goods and business of the Flathead Commercial Company to Buttrey Co. Subsequently, Mr. Thomas Elliot, as the President of the Flathead Commercial Company, executed an affidavit and statement as required by the Montana

Bulk Sales Law (No. 15983, R. 82; No. 15984, R. 36; R. 116, 120, 121, 123).

The business of the Flathead Commercial Company was conducted in a building known as the Buffalo Block in Kalispell, Montana. (No. 15983, R. 82; R. 115).

The Buffalo Block consisted of two stories and a basement and it contained store fronts, brick walls and the usual internal divisions supporting the walls. The Buffalo Block had a 125-foot frontage on Main Street in Kalispell of which the Flathead Commercial Company occupied a 75-foot frontage thereof on the first floor and in the basement. The remaining 50-foot frontage on the first floor and basement was occupied by Safeway Stores in 1945. The second floor consisted of office spaces which were rented to various tenants. Vacancies existed from time to time. Safeway Stores held a lease on the space occupied by them which lease expired in 1947. (No. 15983, R. 82, 83; R. 114-116, 123).

The Buffalo Block was owned by Mr. Thomas Elliot and his brother, Mr. William Elliot, each owning an undivided one-half interest. They had purchased this property in 1923. (No. 15983, R. 83; R. 115).

As shown by Plaintiffs' Exhibit #1, the total gross income from the various tenants of the Buffalo Block (as indicated in the table on the bottom of the exhibit) averaged approximately $16,500, a year for the ten-year period commencing in 1936 and terminating at the end of 1945, that is, just prior to the execution of the so-called "Lease Agreement and Purchase Option" on January

14, 1946. The expense of operating the Buffalo Block averaged approximately $9,500 a year and, as shown on the table at the top of the exhibit, such expense consisted of taxes, heat, office expense, repair, wages, light, water insurance, and general expense and that, in addition, depreciation in the approximate amount of $2,000 was in-incurred. The average annual net income was, therefore, approximately $5,000. (No. 15983, R. 79, 83, 84; R. 112).

During the negotiations with Buttrey Co. concerning the sale of the Flathead Commercial Company, there was no discussion regarding the purchase of the Buffalo Block but it was agreed at that time that Buttrey Co. would be allowed to take over the space then occupied by the Flathead Commercial Company. Buttrey Co. offered to lease such space at $775 a month for 15 years provided they were given the option to lease the space then occupied by Safeway Stores at $425.35 a month at the expiration of Safeways Store's lease in 1947 or sooner should Safeway Stores vacate the premises. These negotiations took place in Billings, Montana during December of 1945, but no agreement was made at that time. (No. 15983, R. 84; R. 122-124).

Subsequent to January 1, 1946, the appellees were again approached regarding the disposition of the Buffalo Block and these negotiations took place in Kalispell, Montana. On January 14, 1946, in the law office of the attorneys representing Buttrey Co., the so-called "Lease Agreement and Purchase Option" was executed. On

February 1, 1946, the supplemental "Memorandum Agreement" was executed. The said agreements were prepared by the attorneys for Buttrey Co. The appellees were not represented by any lawyer and they paid no legal fees in this matter. The Elliot brothers were unfamiliar with tax matters, and also with technical sales agreements and they relied upon Buttrey Co.'s attorneys. They were simply selling their property and all of it. (No. 15983, R. 78, 84, 85; R. 124-127).

The above-referred to agreements specified that an abstract of title, together with a title opinion and a warranty deed, wherein the appellees conveyed the property to Buttrey Co., were to be placed in escrow in the Conrad National Bank at Kalispell, and this was done. The agreements stated that the abstract of title, title opinion, and the warranty deed were to be delivered to Buttrey Co. by said bank provided that full payment was made therefor. (No. 15983, R. 85; R. 127, 128).

After the execution of the agreements, the appellees vacated the premises and subsequent to that time they did not pay any expenses in connection with the Buffalo Block, including real estate taxes or repairs, nor did they collect any rentals from any of the tenants of the building. The appellees completely terminated their relation with the management and control of the building, except to make sure that the insurance was kept up. In Paragraph 4 of the agreement, it is provided that fire insurance in the amount of at least $175,000 be maintained by Buttrey Co. and that Buttrey Co. later increased the amount of insurance on the building, without being requested to do so by the appellees, to the sum of $250,000. (No. 15983 R. 85, 86; R. 128, 137-139).

The fair market value of the property known as the Buffalo Block on January 14, 1946 was approximately $200,000. (No. 15983, R. 86; R. 138, 139, 145-150).

It was intended that Buttrey Co. would make the final $75,000 payment referred to in the agreement. A provision of the "Memorandum Agreement" provided that the parties contemplated the making of this payment and it was, in fact, made on November 5, 1955. The agreements were completely performed on that date, that is, the appellees had received all of the payments provided for therein and Buttrey Co. received the deed, abstract, and title opinion from the escrowee. The terms of the agreement had been performed precisely as written therein and were fully consummated and the agreements constituted a sales agreement and were intended as such by the parties. (No. 15983, R. 77-79, 86; R. 138, 135, 127).

In a further Finding of Fact (No. 15983, R. 86), the District Court found that it has been conclusively established that the Elliot brothers did, in fact, make a sale of their property to Buttrey Co. and that it was so understood by both parties, and that the yearly rentals, so called, were installment payments on the purchase price, and that such is the construction to be placed upon the agreements in question, and that they should be treated accordingly for Federal income tax purposes.

ARGUMENT

The District Court correctly held that the agreement in question constituted a sales agreement rather than a true lease agreement.

1. *GENERAL DISCUSSION.*

Mr. Thomas Elliot, who had owned and operated the Flathead Commercial Company for a number of years, decided to sell the assets of that business and to retire. This decision was made in December of 1945 during which time negotiations were held in Billings, Montana, with Buttrey Co. As the owner and President and manager of such company, he consummated the sale of the assets and business of the Flathead Commercial Company. In conjunction with this sale, Mr. Elliot later executed an affidavit and statement required by Section 8607 of the 1935 Revised Codes of Montana. Said affidavit was executed and acknowledged on January 31, 1946 (No. 15984, R. 36, 37).

During the negotiations held in Billings, Montana, during December of 1945, it was further agreed that Buttrey Co. would have the same space formerly occupied by the Flathead Commercial Company. Buttrey Co. offered to lease the space occupied by the Flathead Commercial Company for $775.00 a month for a period of 15 years with the option to lease the space occupied by Safeway Stores for $425.35 a month at the expiration of their lease in 1947 or sooner should Safeway Stores vacate the premises. Therefore, under this offer, Buttrey Co. agreed to lease the entire first floor and basement space thereunder for a total of $1,200.35 a month for a 15-year period. That is, they agreed to rent the principal part of the Buffalo Block for that sum. This offer did not contain any provision regarding an option to purchase the property and if this offer had been accepted, the Elliot brothers would have continued to be true landlords and would have had to pay the taxes, insurance, repairs, and other necessary costs ordinarily incurred by the owners of business real estate. They would have continued to rent the space on the second floor of the building. At the end of the lease term, the Elliots would still have owned this property. The total gross yearly rental which would have been payable by Buttrey Co. if this offer had been accepted would have been $14,404.20 ($1,-200.35 a month for 12 months). However, this offer was not accepted.

Subsequently, the appellees met with representatives of Buttrey Co. in Kalispell, Montana, in the office of Buttrey Co.'s attorneys and, on January 14, 1946, the so-called "Lease Agreement and Purchase Option" was executed by the appellees and by Buttrey Co. On February 1, 1946, the "Memorandum Agreement" was executed by the same parties. The agreements were prepared by the attorneys for Buttrey Co. and the appellees were not represented by a lawyer and they incurred no legal fees in this matter.

In contrast with their prior offer, Buttrey Co., under the so-called "Lease Agreement and Purchase Option," agreed to pay to the appellees $19,000 a year and, in addition, Buttrey Co. agreed to pay all of the costs and expenses normally incurred by the owner of property. Hence, under this offer, Buttrey Co. would pay $19,000 to the appellees and maintenance expense of perhaps $9,-500 or a total of $28,500. This sum would be offset to a small extent by the rentals from the office space on the second story since the appellees did collect some rentals therefrom when they were not vacant. Of course, their principal rental income had come from the store rentals on the main floor of the building. The total gross rentals per year were some $16,500. The logical reason for making these higher payments can only be explained on the basis that Buttrey Co. knew it was making payments on the purchase price of the property rather than true rental payments for the use of the property.

Prior to entering into this so-called "Lease Agreement and Purchase Option," the appellees received an average of some $16,500 a year in gross rentals and incurred average yearly expenses of $9,500 in addition to approximately $2,000 of depreciation, leaving a net yearly income of approximately $5,000; after the agreement was entered into the appellees received $19,000 a year and they did not incur any expense!

What is the reason for this increase of some $14,000 a year in the appellees' "rental" income?

Certainly the above comparison regarding Buttrey Co.'s prior offer to lease the premises and the comparison between the prior net rental income of some $5,000 earned by the appellees as compared with the net "rental" income of $19,000 after the agreement was executed are additional factors in establishing that the $19,000 yearly "rentals" were not reasonable rent payments for the use of this property but, instead, constituted yearly payments upon the purchase price of the property.

2. *PROVISIONS AND ANALYSIS OF THE SO-CALLED "LEASE AGREEMENT AND PURCHASE OPTION" AND THE "MEMORANDUM AGREEMENT."*

(a) *Provisions of the so-called "Lease Agreement and Purchase Option."*

The agreement contains the following provisions, which are summarized below as they appear by paragraph numbers in the agreement itself:

Par. 1: The appellees "leased" the property described therein (ie, the entire Buffalo Block) to Buttrey Co., subject to existing leases, for a ten-year term.

Par. 2: Buttrey Co. agreed to pay "rent" in the sum of $19,000 a year, the first year's "rental" being paid at the time the agreement was executed.

Par. 3: Buttrey Co. agreed to keep the premises in good repair and not to commit waste.

Par. 4: Buttrey Co. agreed to insure the property against damage or loss by fire for not less than $175,000 and to pay the premium thereon. The appellees were to be paid the proceeds of the policy in case of fire as their interest may appear, provided that in the event of a total loss, Buttrey Co. had the option of acquiring title to the property by paying $75,000 plus the remaining "rentals" for the full ten-year term less the insurance proceeds.

Par. 5: Buttrey Co. agreed to take over all existing insurance policies and to pay the appellees for any unearned premiums computed to February 1, 1946.

Par. 6: Buttrey Co. agreed to pay all state, county and city taxes;

Buttrey Co. agreed to pay all fuel, light, power, and water bills;

Buttrey Co. agreed to fully maintain said property at its own cost and expense.

Par. 7: Buttrey Co. was given the right to assign the "lease" and to "sublet" the premises, and any rentals for "subletting" after February 1, 1946 belonged to Buttrey Co.

February 1, 1946 was the date fixed for turning possession of the premises over to Buttrey Co.

Par. 8: Buttrey Co. was given the right to make alterations and improvements. Before any major improvement or remodeling, the consent of the appellees was required. Buttrey Co. was given the right to remove any fixtures or movable property placed in the premises by them.

Par. 9: Provides for quiet and peaceful possession of the premises.

Par. 10: In case a fire renders the premises untenantable and Buttrey Co. elects to restore the premises to tenantable condition, the insurance proceeds shall be released to Buttrey Co. for this purpose. In the event of fire, Buttrey Co. agreed to notify the appellees in order that they may inspect the damage. If Buttrey Co. does not elect to restore the premises to tenantable conditions, then the "lease" terminates six months after the fire, unless Buttrey Co. exercises the option of purchase under the acceleration clause in Paragraph 4 above.

Par. 11: Buttrey Co. agrees to comply with sanitary regulations and ordinances of Montana and Kalispell. If structural improvements are required under the order of public authority, the expense thereof will be borne by the appellees.

Par. 12: Buttrey Co. is given the "option" to purchase the premises for $75,000 at any time between Nov. 1, 1955 and Jan. 31, 1956, except that it can be exercised sooner if Paragraph 4 applies.

Par. 13: Required the appellees to execute a warranty deed conveying the property to Buttrey Co. and to deliver such deed, together with a copy of this agreement, to the Conrad National Bank of Kalispell with instructions to the bank that said deed be delivered to Buttrey Co. if it exercises the "option" to purchase. Appellees agreed to stand the expense of obtaining an abstract of title which would be held in escrow by the Bank with the warranty deed and a copy of this agreement. It was agreed that if the "option" was not exercised, the bank would return the deed and abstract to the appellees. If the examination of the abstract showed that the title was defective but could be cured, the appellees agreed to correct such defects at their own expense. It was agreed that any and all charges imposed by the Conrad National Bank incurred as "such escrow agent" for its services hereunder should be borne and paid by Buttrey Co.

Par. 14: The appellees were given the right to re-enter and lease the premises if Buttrey Co. vacated or abandoned the premises. If appellees elected to re-enter, it was agreed that any cost of repairs, etc. would be borne by Buttrey Co. and Buttrey Co. agreed to pay, at the end of every year, any deficiency in the yearly "rental" payments.

Par. 15: It was agreed that the heirs, personal representatives, successors and assigns of both parties would be bound by this agreement.

The agreement was duly signed and the signatures of all parties were acknowledged.

(b) *Provisions of the "Memorandum Agreement."*

The "Memorandum Agreement" was executed by the same parties on February 1, 1946 and it was acknowledged on that date. It provided that the appellees, "in contemplation of the exercise of said option," agreed to immediately deliver to the Conrad National Bank of Kalispell, Montana an executed warranty deed conveying the property to Buttrey Co. and also an abstract of title covering said property showing that the appellees were vested with a merchantable title as of January 14, 1946, the date the so-called "Lease Agreement and Purchase Option" was executed.

(c) *Discussion of the Agreements.*

Under Paragraph 1 of the so-called "Lease Agreement and Purchase Option," the appellees "leased" the property to Buttrey Co. for an agreed "rental" of $19,000 a year, a figure greatly in excess of a fair and reasonable rental.

Pursuant to Paragraph 2, Buttrey Co. was to receive the rentals from Safeway Stores and the second story offices after February 1, 1946. If Buttrey Co. were really only leasing or renting the space formerly occupied by the Flathead Commercial Company, there would have been no reason to assign the upstairs' rentals and the rentals from Safeway Stores to Buttrey Co.

Under Paragraph 3, Buttrey Co. agreed to keep the premises in good repair and not to commit waste. This provision is one typically found in a mortgage where the mortgagors have sold property under an agreement providing for the purchase price to be paid over a period of years.

Pursuant to Paragraph 4, Buttrey Co. agreed to insure the property for not less than $175,000 and to name the appellees as the beneficiaries of the insurance policies.

If a total loss occurred, Buttrey Co. had the "option" of acquiring title to the property by paying $75,000 plus the remaining "rentals" for the full term less the insurance proceeds. That is, if a total loss had occurred say one day after the execution of the agreement, the "option" could be "exercised" by making a payment of $71,000 ("option" price of $75,000 plus the remaining "rentals" of $171,000 (total "rentals" of $190,000 of which $19,000 was paid concurrently with the execution of the agreement) less $175,000, the insurance proceeds). Said sum of $71,000 is substantially smaller than the fair market value of the land on the date the agreement was executed. The fair market value of the land on that date was about $116,875.

If a fire had occurred say one year after the execution of the agreement, the "option" could have been "exercised" by making a payment of $52,000. If a fire had occurred two years after the execution of the agreement, the "option" could have been "exercised" by making a payment of $33,000; if a fire had occurred three years after the execution of the agreement, the payment would have been $14,000; and if a fire had occurred four or more years after the execution of the agreement, the "option" could have been "exercised" by paying $0.

There was no question under the above formula that the "option" would be exercised, even if a fire occurred the day after the agreement was signed. That is, the "option" price under the above formula was always substantially less than the fair market value of the land. As shown above, four years after the agreement was executed, the "option" price was $0 in case of a fire.

This provision of the agreement also shows that the "option" price was not a realistic and bona fide figure representing the fair market value of the property. If the "option" price of $75,000 had actually represented the fair market value of the property, there would have been no reason to require Buttrey Co. to pay all of the remaining rentals for the full 10-year term in addition to the $75,000 in order to exercise the "option."

In Paragraph 5, the appellees assigned all of their existing fire insurance policies to Buttrey Co., which is a usual provision in sales contracts.

In Paragraph 6, Buttrey Co. agreed to pay the state, county, and city taxes. In addition, Buttrey Co. agreed to pay all fuel, light, power, and other bills. These expenses are those normally assumed by a purchaser of property.

In Paragraph 7, Buttrey Co. had the right to assign or sublet the premises. They could, therefore, freely assign or sell their interest in this property. This provision is typical in sales contracts whereas, it is a common practice in leases to provide that the lessee can assign the lease only with the consent of the lessor.

In Paragraph 8, Buttrey Co. had the right to make alterations and improvements.

If major remodeling were contemplated, the consent of the appellees was required. This provision is a normal provision inserted to protect a seller before the purchase price has been fully paid.

Under Paragraph 9, Buttrey Co. was guaranteed quiet and peaceful possession during the full "lease" term.

Under Paragraph 10, Buttrey Co. had the right, if they so elected, to have the insurance proceeds paid to them to make the premises tenantable after any fire loss.

In Paragraph 11, Buttrey Co. agreed to comply with sanitary regulations, etc. Any structural improvements required by public authority would be borne by the appellees. This provision is in the nature of a warranty by them that the premises were suitable under rules imposed by public authority.

In Paragraph 12, Buttrey Co. had the "option" to purchase the property for $75,000 between November 1, 1955 and January 31, 1956. This "option" price was a totally unrealistic figure. It is not anywhere near the fair market value of the property at the time the agreement was executed and certainly was not a bona fide figure for Federal income tax purposes. It was, of course, from a practical businessman's point of view, an absolute certainty that Buttrey Co. would "exercise" its "option." Indeed, Buttrey Co. directors and officers would have been grossly negligent if the "option" had not been "exercised" after building up such a substantial equity in the property in the form of yearly "rentals." The "Memorandum Agreement" provides that the parties contemplated exercising the "option" and Mr. Elliot testified that he knew that Buttrey Co. would exercise its "option." The "option" was, of course, "exercised" on November 5, 1955. It is significant that the "option" could not be "exercised" until November 1, 1955; that is, it was not exercisable until all of the "rentals" totaling $190,000 had been paid for the full 10-year period.

Pursuant to Paragraph 13, the appellees executed a warranty deed conveying the property to Buttrey Co. The appellees agreed to pay the expense of obtaining an abstract of title. The deed and abstract were placed in escrow with the Conrad National Bank. All of the charges of such escrow agent were borne and paid for by Buttrey Co.

In the "Memorandum Agreement" it was provided that the appellees would place an abstract of title showing that they were vested with merchantable title as of January 14, 1946, the date the so-called "Lease Agreement and Purchase Option" was signed. That is, Buttrey Co. accepted title as of January 14, 1946.

Under Paragraph 14, the appellees had the right to re-enter if Buttrey Co. vacated or abandoned the premises.

In Paragraph 15, it was agreed that the heirs, assigns, and personal representatives were bound by this agreement.

3. *LEGAL AUTHORITIES.*
Watson v. Commissioner, 62 F. 2d 35 (9th Cir. 1932), *aff'g.,* 24 B. T. A. 466 (1931).

Prior to 1923, Mr. Watson had been engaged in operating a bus line between Los Angeles and Santa Ana, California. His property consisted of 20 busses, furniture and fixtures, operative rights to certain depot facilities, and subleases relating to depot concessions.

In November, 1922, he agreed to sell his bus line for $100,000, but the sale was cancelled after he was informed that the Railroad Commission of California, which had jurisdiction over the matter, would disapprove the sale.

Thereafter, during February, 1923, another agreement was entered into. This agreement was entitled "Lease and Option Agreement." It provided that Mr. Watson leased the property for a term of 47 months for a total rental of $109,900 payable $10,000 upon execution of the agreement, $20,000 after approval thereof by the Railroad Commission, and $1,700 monthly until fully paid. Mr. Watson agreed to transfer and vest in the lessee valid title to one of the 20 busses, purportedly leased thereby, upon the payment of each of said monthly rentals, and should the lessee pay said rentals and otherwise perform the covenants of the lease, then it was given the option of purchasing said properties for the sum of $1.00 cash.

This transaction was approved by the Railroad Commission and Mr. Watson received the initial payment of $10,000. He received $20,000 after the approval of the Railroad Commission and, thereafter, he received all of the monthly rentals of $1,700. When each of the monthly payments were made, Mr. Watson delivered title to one of the 20 busses and at the completion of the monthly rentals all of the property was conveyed and assigned to the lessee.

The 9th Court of Appeals held that, considering the instrument as a whole and what the parties had done, the legal effect of the instrument constituted a conditional sale.

The Court stated it was free to construe the instrument in question and form its own independent judgment as to its legal effect and that it was not bound by the construction, if any, placed upon it by the Railroad Commission.

The Court said that:

> "We have approached the construction of this agreement under the rule recognized by the Supreme Court in Heryford v. Davis, 102 U. S. 235, 244, where the Court said: ' . . . (it) is not to be found in any name which the parties may have given to the instrument, and not alone in any particular provisions it contains, disconnected from all others, but in the ruling intention of the parties, gathered from all the language they have used. It is the legal effect of the whole which is to be sought for. The form of the instrument is of little account.' "

The Court said that the so-called "rentals" were not intended to represent rent but were payments on account of the purchase price. The Court said that the option clause was meaningless from a practical point of view when the instrument as a whole was considered.

> *Oesterreich v. Commissioner,* 226 F. 2d 798 (9th Cir. 1955).

Plaintiff acquired three adjoining lots in Beverly Hills, California in 1926. Under date of September 11, 1929, the plaintiff entered into an agreement entitled "lease" with the Wilshire Amusement Corporation. The plaintiff is referred to as the lessor and the corporation is referred to as the lessee. The agreement also provided for payments called rent to be paid by the lessee.

The lessee agreed to pay the lessor total rent of $679,-380 payable in monthly installments for a period of 67 years and eight months beginning September 1, 1929 and ending the last day of April, 1997. The rental schedule provided for an annual rental of $7,500 for the first 10 years, $12,000 for the succeeding 18 years, and amount becoming progressively smaller so that the rental for the 68th year was $7,500. The lessee agreed to pay all taxes and similar charges on the property. The lessee agreed to erect a new building on the premises to cost not less than $300,000 and to be completed not later than July 1, 1930. The lessor agreed to join in the execution of notes or debentures and in a deed of trust or mortgage covering the leased premises to secure a loan not to exceed $225,000 to be used in constructing the building. The lessee agreed to take out adequate fire insurance on the building and insurance to protect lessor from claims arising out of the use of the premises. The agreement states that the lessee proposes to sublease a portion of the building for theatre purposes. The lease could be assigned by the lessee upon the terms stated therein and such an assignment would release the lessee of further obligations under the lease. The lessor could declare the lease terminated in case of default continuing longer than a period stated in the lease. The lessee had the right, but was not bound, to tear down any building which might be built on the premises for the purpose of reconstruction. Any such replacement was to cost not less than $325,000.

Another paragraph of the lease provided that, when the lease expired and all the conditions had been met, the lessor agreed that she would convey the property to the lessee upon receipt of the sum of ten dollars.

The lessee paid the taxpayer $12,000 in each of the years 1945 and 1946 in accordance with the agreement and entered the amounts so paid as rental expense. The plaintiff, on her returns for 1945 and 1946, reported the $12,000 as income from rents. She received a letter from an Internal Revenue Agent in Charge indicating overpayments in her income tax for 1945 and 1946, and enclosing a report in which it was stated that she had reported rental income of $12,000 for the years 1945 and 1946, but investigation showed that the agreement under which these payments were made was "not a lease, but in effect an installment sale of realty under Section 44(b) of the Internal Revenue Code," and she had, therefore, overstated her income for each year by $6,206.91 in that connection. She received another letter from the same source dated July 26, 1949 in which the agent reversed his previous conclusion.

The 9th Court of Appeals stated that the sole issue is whether the agreement is a lease or a contract for the sale of land and the Court observed that in making determinations of this sort, the courts commonly consider the intent of the parties and the legal effect of the instrument as written.

The Court said it was well settled that calling such a transaction a "lease" does not make it such if, in fact, it is something else and, to determine just what it is, the courts will look to see what the parties intended it to be. Both parties have at all times referred to the agreement as a lease and they have treated the payments as rental income and rental expense respectively. However, the Court said the test should not be what the parties call the transaction nor even what they may mistakenly believe to be the name of such transaction. The Court said that what the parties believe the legal effect of such a transaction to be should be the criterion. The Court said that if the parties enter into a transaction which they honestly believe to be a lease but which in actuality has all the elements of a contract of sale, it is a contract of sale regardless of what they call it or treat it on their books. *The Court said that we must look to the intent of the parties in terms of what they intended to happen.*

The Court said that it is clear that it was intended that title to the premises was to pass to the lessee at the end of the 68-year term. The Court said that what the parties intended and the legal effect of the transactions were one and the same and that the intent of the parties should not be considered apart from the legal effect of the agreement.

The Court cited Section 23(a) (1) (A) of the 1939 Internal Revenue Code and said that if the lessee is either taking title to the property or has acquired an equity, it cannot treat the payments as rental expense. The Court said there can be no doubt that the lessee is acquiring title to the premises since it can acquire property now worth $100,000 for $10.00.

The Court distinguished *Benton v. Commissioner,* 197 F. 2d 745 (5th Cir. 1952), on the ground that in the *Benton* case the option price constituted full consideration for the premises or goods acquired and that it was always questionable whether or not the option would be exercised. Further, in the *Benton* case, the rental payments were reasonable in amount.

In conclusion, the 9th Court of Appeals held that the effect of the transaction was that the plaintiff had made a sale of property and was entitled to treat the proceeds as long-term capital gains. The Court relied upon the following cases:

Judson Mills v. Commissioner, infra; Taft v. Commissioner, infra; Helser Machine & Marine Works v. Commissioner, infra; Chicago Stoker Corp. v. Commissioner, infra.

Haggard v. Commissioner, 24 T. C. 1124 (1955).

Petitioner was engaged in operating a ranch in Arizona. In early 1948, he owned 1340 acres, some of which adjoined acreage owned by John Butler. On Feb. 9, 1948, Butler contacted the petitioner to ascertain if he was interested in purchasing 160 acres of farm land for $48,000. Petitioner had formerly tried to purchase the same property for approximately $100 to $150 per acre.

After some discussion, Butler and petitioner went to the office of petitioner's attorney who suggested that the transaction be handled by the execution of a "lease" under the terms of which petitioner would rent the property for the balance of 1948 for $10,000 and $12,000 for 1949 and the petitioner would have the "option" to purchase the acreage after January 1, 1949, and before January 10, 1950 for $24,000. A separate consideration of $2,000 was given for the "option."

In 1947, the fair or reasonable rental for the property would have been from $3,000 to $4,000 a year and, in 1948, it would have been about $5,000 a year.

Petitioner treated the sum of $12,000 paid to Butler on January 1, 1949 as rental expense pursuant to the "lease" and deducted this amount from his gross income.

The Court stated that the sole issue in the case is whether the so-called "rental" payment was in fact a payment of rent under the "lease" and deductible as such, or a partial payment of the purchase price of the property.

The Court held that the payments were not deductible. The Court said:

> "The principle extending throughout the cases heretofore decided by us on like issues is that where the "lessee", as a result of the "rental" payment, acquires something of value in relation to the over-all transaction, other than the mere use of the property, he is building up an equity in the property, and the payments do not, therefore, come within the definition of rent in Section 23(a) (1) (A), supra."

The Court said that Butler would not have considered making an outright sale for $24,000 and that it was likewise clear that the payments in 1948 and 1949 were in excess of the fair rental value of the property and were fixed at amounts which, when added to the option payment of $2,000 and the ultimate "sale price" of $24,000, would equal the $48,000 which he wanted for the property.

The Court said that a significant aspect of the over-all transaction indicative of petitioner's intent to acquire an equity interest in the property is the fact that under the "lease", the aggregate "rental" payments constituted 91% of the purchase price stated in the "option" and they also constituted about 46% of the total consideration passing from the petitioner to Butler.

On December 6, 1956, the 9th Court of Appeals affirmed the Tax Court *per curiam (241* F2d *288).*

In reviewing the Tax Court decision, the 9th Circuit noted that two documents were entered into between one John Butler and the taxpayers. The form of these two instruments was to lease 160 acres of land to the taxpayers during the latter part of 1948 for $10,000, in 1949 for $12,000, and to grant an option for $2,000 cash to purchase the land after January 1, 1950, and before January 10, 1950, for $24,000.

The 9th Circuit said that the net effect of these two documents was to confer an equity in the property to the taxpayers and that the Tax Court was correct in so holding. The Court said that the intent of the parties was perfectly plain and that the bare fact that one of the documents was drawn in lease form is of no consequence. The Court said that "the purpose of the contracts was clear, and, therefore, the tax consequences are well settled."

Holeproof Hosiery Co. v. Commissioner, 11 BTA 547 (1928).

On July 27, 1921, the petitioner, as lessee, entered into four lease agreements with a textile company. Each lease provided for rent to be paid on four machines manufactured and owned by lessor. The rent to be paid was $800 a month for the four machines plus the cost of fire insurance thereon. The lease term was 30 months. The total cash rental was therefore $24,000.

The four machines were valued at $26,650.

The lessee could not sell or remove the machines to a new location without the consent of the lessor.

The lessee agreed to keep the machines in good repair.

The lessee agreed that no alterations would be made without the written consent of the lessor.

The lessee agreed not to sell the machines without the written consent of the lessor.

The lessee agreed not to assign the lease or sublet or in any way dispose of the leased property.

The lessee agreed to return the machines in good condition upon the termination of the lease.

Upon the termination of the lease term, the lessee had the option of purchasing the four leased machines for $5,677.26. The lessor agreed to execute a bill of sale if the option was exercised.

The lessee, in case the machines were lost or destroyed, was required to pay the lessor the stated value of the machines, with interest, less the rent previously paid.

The lessor had the right of inspection.

The lessee was to insure the machines in the name of the lessor and pay all taxes assessed and levied against the leased property.

The machines mentioned in the leases were delivered to the petitioner and installed several months after July 27, 1921. They were still in use in January, 1927.

The petitioner claimed, as a deduction for rent on these 16 machines for the year 1921, the amount of $13,-060, which amount the Commissioner disallowed as a deduction on the ground that it represented a capital expenditure.

Held: "Rent" deduction disallowed.

The Court cited from what is now Section 23(a) (1) (A) of the 1939 Internal Revenue Code to the effect that a deduction is allowed for rentals or other payments required to be made as a condition to the continued use or possession of property to which the taxpayer has not taken or is not taking title, or in which it has no equity.

The Court said:

> "The evidence in this case indicates that at the end of the year 1921 the petitioner had a substantial equity in these machines. We do not know the life of the machines, but we do know that they were still in use five years after the taxable year in question. We do not know at what amount the machines could be rented on the open market, but we know that the total amounts to be paid under the lease agreements before the title to the machines was to pass to the petitioner exceed but slightly the stated value of the machines, and it is inconceivable that the petitioner was not acquiring something of value, that is, a certain equity in the machines, with each payment made in accordance with the agreement. The statute does not allow the deduction claimed."

Smith v. Commissioner, 20 B. T. A. 27 (1930);
Shannon v. Commissioner, 20 B. T. A. 27 (1930).

A partnership entered into a lease agreement involving a building. The agreement was to be in effect for a 20-year term. Shannon, as lessee, agreed to pay the partnership $1,000 a month during the full term of 20 years. He also agreed to assume and pay as "additional rental" the interest on an existing loan of $60,000 on the property.

All taxes and fire insurance premiums were to be paid as "additional rental" by the lessee.

Lessee agreed to keep the building in good repair and to comply with all improvements and changes recommended by the insurance associations.

If the property was damaged or destroyed by fire, the insurance collected by the partnership "as owners thereof" was to be applied to the purpose of rebuilding, but the lessee was required to continue the rental payments. The lessor, however, was entitled to any recovery for such damage which the partnership might obtain.

The lessee was given the right to make such improvements in the building and premises as in his judgment he deemed necessary to the full enjoyment thereof.

The lessor had the right of entry upon the premises.

The lessee had the right to "sublet" the property.

The purpose and intent of the agreement was recited to be that the lessee pay all amounts necessary to yield $1,000 per month net to the partners "as rental."

In case the lessee performed all of the obligations of the agreement and, in addition thereto, paid the additional sum of $10.00 to the partners, they obligated themselves to execute and deliver to him a fee simple deed to the property. The partners also obligated themselves to execute a fee simple deed to the property and deposit it in escrow with a bank to be held by the bank for delivery when the agreement had been fully complied with.

This case involved the income tax liability of both the lessee (Shannon) and one of the partners (Smith).

Held: The Court, after citing cases, held that the relationship between the parties was not one of lessor and lessee, but of vendor and vendee; the transaction was a conditional sale and the payments made were not rent, but were payments on the purchase price. The Court said the execution and deposit of the deed in escrow further strengthened their views for the grantor had no control or power over the escrow deed and could no more countermand the delivery thereof than of an absolute deed, and it is always in the power of the grantee to entitle himself to the deed by performing the conditions in the agreement.

> *Helser Machine & Marine Works, Inc. v. Commissioner,* 39 B. T. A. 644 (1939).

Under an agreement called a lease, dated April 1, 1935, the petitioner became the lessee, from May 1, 1935 until April 30, 1945, of a piece of real property and he agreed to pay rent in monthly payments of \$160 each. The lease provided that at any time the lessee paid the total rentals of \$19,200 he would be entitled to receive a warranty deed to the property.

Petitioner deducted the "rent" paid in 1935 on his 1935 tax return.

Held: Deduction disallowed. The Court cited what is now I. R. C. Sec. 23(a) (1) (A) and said that from this statutory language it is clear that a taxpayer does not establish a deduction merely by showing that the amount paid is called rental, or that, regardless of nomenclature, it is rental in that the consideration for its payments is to some extent the possession, use and occupancy of the property. The only rental which may be deducted is that "of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

Taft v. Commissioner, 27 B. T. A. 808 (1933).

A corporation was the owner of a certain lot and building thereon. Petitioner made a written offer to

> "purchase the property for $185,000 on the following terms: $50,000 in cash and $25,000 at the end of 5 years and an additional $25,000 at the end of 10 years and the balance of $85,000 to be the privilege of purchase at the end of the lease."

Thereafter, the parties executed an agreement called a lease and the lessor received a payment of $50,000 under the lease, and the lessee agreed to pay $6,750.00 annually. The lessee had the option to purchase the property at any time upon payment of the sum of $135,000 and the payment of all arrearages under the lease. The lessor agreed to execute a warranty deed if the petitioner elected to buy the property.

Lessee agreed to pay all taxes, assessments and insurance and such payments were to be made even if the premises were destroyed by fire or otherwise. Lessee agreed not to commit waste or to use the property for any unlawful purposes, nor assign the lease without written consent of the lessor.

Lessee agreed to keep the building insured for $20,000 and if said building were destroyed by fire, etc. the recovery thereon was to be used to restore the building or, at the option of the lessee, paid to the lessor as a partial payment on account of the privilege of purchasing the property.

The corporation's president was of the opinion that the "privilege of purchase" was actually an obligation to purchase and this was the purpose and effect contemplated by him at the time. The corporation's tax return for the year in which the agreement was executed was filed on the basis that a sale and not a lease resulted from the agreement for payment of its federal income tax burden, and its tax liability for that year was determined on that basis.

Petitioner contended that the transaction was not a sale, but only a lease for 15 years and that, therefore, he was entitled to have the $50,000 initial payment for the lease amortized over the life of the lease and deducted from gross income.

Held: The agreement constituted a sale and no deduction for rent is allowable.

The Court said that its purpose was to determine the true character of the transaction. Calling it a "lease" does not make it such, if, in fact, it is something else. Considering all the facts and circumstances of this case, the Court held that the $50,000 payment could not be amortized. The Court was influenced by the fact that the lessee had originally offered to buy the building and the lease agreement was worked out along the lines of the prior offer to buy.

Judson Mills v. Commissioner, 11 T. C. 25 (1948) (A).

Petitioner was a manufacturer of cotton and rayon textile products. The machinery and equipment was somewhat obsolete in 1938 and it was decided to take steps to modernize such property.

New equipment was installed under three separate agreements whereby the manufacturer, designated the lessor, purported to lease the equipment for stipulated monthly payments, termed rentals, to petitioner, designated lessee. Prior to making these agreements, petitioner and the manufacturer reached a precise understanding as to how the recurrent payments should be computed and the factors entering into the totals payable, and their understanding was set forth in correspondence between them.

The first agreement provided for a rental aggregating $25,958.64 for a two-year period, of $25,958.52 for the next three years, and of $6,198.87 on the exercise of an option.

Lessee agreed to keep the machine safe and to carefully use it; to keep it insured; to pay all taxes; not to remove it without the lessor's consent; to keep the machine in good repair and to buy all necessary replacement parts from the lessor; to return the machine in good condition at the end of the lease term; and if the lessee defaulted, the lessor could terminate the lease and take possession of the property.

Upon the termination of the lease, the lessee had the option to purchase the property for $6,198.87. If the option were exercised, the lessor agreed to execute and deliver to the lessee a bill of sale for the machinery.

Th second lease agreement was for a term of 4½ years unless previously terminated or extended. The lessee agreed to pay rent of $125,086 in monthly installments.

The lease provided that the machines remained the sole and exclusive property of the lessor and that the lessee had no right of property or equity therein, but only the right to use the same in the manner and upon the conditions set forth in the lease.

If the lessee defaulted, all payments becoming due subsequent to such default at the option of the lessor became immediately due and payable.

The lessee had the option to buy the machines at the end of the lease term for $12,850.

The third lease agreement was for a seven year term. The aggregate rent payable was about $184,644.

The lessee had the option to purchase the property at the end of the lease term for $18,950.

The remainder of the third agreement was substantially the same as the second agreement.

Petitioner ultimately exercised the option of purchase in all three agreements.

Petitioner deducted $30,786.78 as machinery rentals in its 1940 tax return.

Held: Petitioner's payments under the three agreements were not rentals of machinery, but constituted the purchase price thereof. The Court said that by the payments the petitioner made on the machinery it acquired an equity in the property and thence the "rental" payments were not deductible under I. R. C. Sec. 23(a) (1) (A). The Court relied on the *Holeproof Hosiery Co. v. Commissioner, supra; Smith v. Commissioner, supra;* and *Helser Machine & Marine Works, Inc. v. Commissioner, supra.*

Truman Bowen v. Commissioner, 12 T. C. 446 (1949) (A).

A partnership furnished equipment to the U. S. Government during 1941 for use at construction work to which the Government took title during 1942. The value of each item of equipment was agreed upon. The agreement was called an "equipment rental agreement." The monthly payments were treated as equity of the Government under the agreement. Title was to pass to the Government when the monthly payments equalled the agreed value plus charges for interest at the rate of 1% of value per month plus freight. If the monthly rentals did not equal the agreed value upon completion of specific projects, the Government could take title upon completion of work by a further payment which, added to the monthly payments, would equal the agreed value, plus 1%, plus freight.

Held: The monthly payments were sales proceeds and did not constitute rent income under I. R. C. Section 22(a).

The Court said that the determination of whether an agreement is a lease or a conditional sales contract is controlled neither by form nor by the use of the terms "lease" and "rent". It is necessary to look through the form to the substance and the courts will always look to its purpose, rather than to the name given to it by the parties. The Court said that the contract had to be construed in accordance with what the evidence shows to have been the purpose of the entire agreement.

The Court further said:

> "The agreement resembled, therefore, the type of agreements where monthly payments are to be made for a stated period, and at the end of that period a small additional payment is to be made to acquire title. See, for example, the following cases where the period of the agreement was for a stated number of months or years, and, at the end of the period, if monthly payments were not in default, the "lessee" could acquire title to property upon payment of a small additional amount: *Holeproof Hosiery Co., supra;* and *Judson Mills, supra,* where the contracts were held to be something other than an ordinary lease, the holding as to the nature of the monthly payments being that they were not rent for purposes of the income tax. See, also, *Helser Machine & Marine Works, Inc., supra.*"

1939 I. R. C. Section 23(a) (1) (A) defines rent as payment for the use or possession of property. It excludes from the term "rent." payments for the use or possession of property to which the taxpayer is taking title, or in which he has an equity. The Court concluded that the payments in this case were not rent for Federal income tax purposes.

Chicago Stoker Corp. v. Commissioner, 14 T. C. 441 (1950).

The President of the Eddy Stoker Corp. learned in 1941 that the Whiting Corporation wanted to dispose of its stoker division. He learned that the stoker division had been losing money and that Whiting Corporation wanted someone to carry on this business who would provide service and parts for stokers which Whiting Corporation had sold in the past. He did not want to buy the business because he thought the cost would be too much for him to finance and also he did not want to pay anything for it until he could learn whether or not he could operate it profitably.

Whiting Corporation and Eddy Stoker Corp. entered into an agreement dated March 13, 1941, whereby Whiting agreed to sell the stoker business. Eddy Corp., although described as the "buyer", did not expressly agree to buy, but agreed to pay royalties in the stokers manufactured and sold in amounts set forth in the agreement.

One of the provisions in regard to royalties provided that when the total of the royalties paid by the "Buyer" to the "Seller" amounted to $70,000 no further royalties were to be paid and the title to the business and property shall vest in the "Buyer."

A minimum royalty of $2,500 a year was payable for the first two years.

Eddy Corp. was not committed to make any effort to sell stokers and it could at any time return the business and property to Whiting and thereby be released from further liability under the agreement. The title to the business and property was to remain in the seller until the $70,000 of royalties was paid in full.

Eddy Corp. organized a new corporation, the petitioner, and assigned the agreement to it. The petitioner made total payments of $30,000 to Whiting prior to September 2, 1944, based on sales of stokers. In 1942 and again in 1944, the petitioner gave serious consideration to the possibility of returning the stoker business to Whiting.

The petitioner made a final payment of $40,000 to Whiting in September, 1944, and on September 2, 1944, sold the business to another corporation.

The petitioner, on its returns for 1941 through 1942 deducted the payments made to Whiting in those years. The Commissioner disallowed the deductions on the basis that they were not deductible under 1939 I. R. C. Sec. 23(a) (1) (A), and determined a gain from the sale of the business in 1944, using $70,000 as the cost of the business.

Held: For the Commissioner. Deductions disallowed.

The Court relied on *Judson Mills v. Commissioner, supra;* and *Truman Bowen v. Commissioner, supra.* The Court said:

> "The petitioner by reason of the payments here in question was able to use the property during the taxable years. The payments were made unconditionally in the sense that they were never going to be returned to the petitioner. The petitioner was not re-

quired to buy the property. The arrangement was that when the payments amounted to $70,000 the petitioner would receive title to the property. The petitioner was to have no legal title to the property until the payments equaled $70,000 and was never to have any title to the property unless the payments equaled $70,000. The evidence indicates, that, if royalty payments had been made in accordance with the agreement, it would have been about 15 years before they would have amounted to $70,000. The petitioner on two occasions had seriously considered giving up the contract altogether and returning possession of the property to Whiting.

Cases like this, where payments at the time they are made have dual potentialities, ie., they may turn out to be payments of purchase price or rent for the use of property, have always been difficult to catalogue for income tax purposes. A fixed rule for guidance of taxpayers and the Commissioner is highly desirable, and it is also desirable that the rule, whatever it is, be as fair as possible, both to the taxpayer and the tax collector. If payments are large enough to exceed the depreciation and value of the property and thus give the payer an equity in the property, it is less of a distortion of income to regard the payments as purchase price and allow depreciation on the property than to offset the entire payment against the income of one year. That is the rule laid down in the *Judson* case and it finds support in Section 23(a) (1) (A). The payee, meanwhile, is not reporting the payments, since they are purchase price rather than rent, and his gain or loss can be determined at the time of the final outcome of the transaction. The *Judson Mills* and *Truman Bowen* cases, being the most recent ones and seeming to establish the more equitable rule, will be followed herein and the Commissioner's disallowance of the deductions will be allowed to stand."

For other cases holding that agreements which were entitled leases and which provided for rent payments which were actually sales or conditional sales contracts see:

Goldfield of American, Ltd. v. Commissioner, 44 B. T. A. 200 (1941);

Lodzieski v. Commissioner, 3 T. C. M. 1056 (1944);

Rotroite Corporation v. Commissioner, 117 F. 2d 245 (7th Cir. 1940);

Lemon v. United States, 115 F. Supp. 573 (D. C. Va. 1943);

Browning v. Commissioner, 9 T. C. M. 1061 (1950);

Renner & Movius, Inc. v. Commissioner, 9 T. C. M. 451 (1950);

McWaters v. Commissioner, 9 T. C. M. 507 (1950);

Graves v. Commissioner, 11 T. C. M. 467 (1952).

4. *SUMMATION OF APPELLEES' CONTENTIONS.*

Mr. Thomas Elliot was the operator of the Flathead Commercial Co. in Kalispell for a number of years prior to January of 1946. In addition, he and his brother owned the business property known as the Buffalo Block in Kalispell.

Due to reason of his health, Mr. Thomas Elliot desired to sell the Flathead Commercial Co. and this was done in December of 1945 and January of 1946. He also desired to retire from the operation of the Buffalo Block and, therefore, on January 14, 1946 he and his brother entered into the so-called "Lease Agreement and Purchase Option." On February 1, 1946, the supplemental "Memorandum Agreement" was executed by the same parties.

These agreements were prepared by the attorneys for Buttrey Co. and were executed in Kalispell, Montana. The plaintiffs were not represented by a lawyer and they incurred no legal fees in this matter.

The agreements were fully carried out and on November 5, 1955 the final payment, called an "option," was made and the deed, abstract, and title opinion rendered as of January 14, 1946 were delivered to Buttrey Co. by the escrow holder who was paid its fee by Buttrey Co.

The provisions of the agreements are set forth and discussed hereinabove. It seems clear after analysing the agreements that it was the intention of the parties that Buttrey Co. was acquiring an equity in the property and that the parties contemplated the payment of the final $75,000 payment labeled an "option" price. The purpose of the agreement and the intention of the parties was to transfer title and to contract for sale.

The comparison between the appellees gross rental income of $16,500 a year and its net rental income of some $5,000 a year prior to entering into this agreement and their net yearly "rental" income of $19,000 after the agreement was signed is further evidence that the $19,000 payments were not true rent payments for the use of this property.

The comparison between Buttrey Co.'s offer to rent the first floor and basement for some $14,000 a year and the $19,000 a year payments under this agreement whereunder Buttrey Co. also agreed to pay all the taxes, insurance, and other expenses, which they would not have incurred under an ordinary lease agreement, less a partial offset for the second story office rentals which it could receive also indicates that Buttrey Co. was buying the property rather than renting it.

The "option" price of $75,000 was greatly below the value of the property in 1946. Mr. Thomas Elliot testified that in his opinion the property was worth in excess of $200,000 at the time the agreement was signed. Mr. S. Geddes, an expert real estate appraiser, stated that the value of the land alone was worth $116,875 in 1946 and he stated that in his opinion the building was worth at least $175,000 at that time. In its Findings of Fact, the District Court found that the property was worth approximaely $200,000.

It is significant that Buttrey Co. did not have the right to exercise the "option" at any time. That is, it could only be exercised on a date after Buttrey Co. had paid the yearly payments of $19,000 for 10 years. It is submitted that if the "option" price had been a bona fide fair market price, it would have been unnecessary to provide that it could not be exercised until the end of the term and then only after Buttrey Co. had paid total "rentals" of $190,000.

It is further noted that Buttrey Co. accepted the title opinion as of January 14, 1946. That is, they accepted title to the property as of that date.

It is also noted that no one testified against the appellees in these cases nor were their witnesses crossexamined.

It seems clear that, under the facts of these cases, the agreement constituted a conditional sales argreement and was so intended by the parties and that the appellees are entitled to treat the yearly payments thereunder as proceeds from the sale of the property involved rather than as rental income subject to ordinary income tax rates.

It is clear that the courts will look to the substance rather than the form in order to determine the Federal income tax consequences of an agreement of this kind. This is the universal rule and it has been applied in three cases in the 9th Court of Appeals, *Watson v. Commissioner, supra; Oesterreich v. Commissioner, supra; Haggard v. Commissioner, supra.*

The Tax Court has attempted to distinguish leases from sales by considering the intention of the parties as such intention can be determined by an objective test based upon the size of rental payments, the option price, and the value of the property. See *Judson Mills v. Commissioner, supra; Chicago Stoker Corp. v. Commissioner, supra; Taft v. Commissioner, supra; Helser Machine & Marine Works, Inc. v. Commissioner, supra; Holeproof Hosiery Co. v. Commissioner, supra.*

The Tax Court has held that the lessee has an equity if the option price is substantially less than the value of the property or that the option price represents a relatively small proportion of the total consideration paid. In *Chicago Stoker Corp. v. Commissioner, supra,* the court said:

> "If payments are large enough to exceed the depreciation and value of the property and thus give the payer an equity in the property, it is less of a distortion of income to name the payments as purchase price and allow depreciation on the property than to offset the entire payment against the income of one year."

In the *Oesterreich* case, the 9th Court of Appeals cited the above cases with approval, and it is clear that under the rule of these cases that the agreement in this case constitutes a conditional sales agreement.

In *Benton v. Commissioner,* 179 F. 2d 745 (5th Cir. 1952), the 5th Court of Appeals stated that in determining the intent of the parties, the objective factors are only some of the considerations to be taken into effect in determining the ultimate question of whether the agreement constitutes a lease or a conditional sale. In the *Benton* case, the court found as facts that the rental payments were reasonable in amount and that the option price was a realistic figure in view of the circumstances in the case. Therefore, the court held that the agreement in that case was a true lease and that the payments made by the lessee were deductible.

In the *Oesterreich* case, the 9th Court of Appeals distinguished the *Benton* case on the grounds that, in that case, the option price constituted the full consideration for the property acquired. It is submitted that the cases at bar are distinguishable from the *Benton* case for the same reason. The "option" price of $75,000 represented at the most only about 35% of the value of the Buffalo Block at the time the agreement was entered into. The balance of the purchase price was made up in the form of the yearly "rentals."

In *Haggard v. Commissioner, supra,* the "option" price was $24,000 and it represented approximately 50% of the value of the property. The Tax Court noted that the aggregate of the "rental" payments constituted 91% of the purchase price stated in the "option" and that the total annual "rental" payments was about 46% of the total consideration passing to the seller.

In the cases at bar, the "option" price of $75,000 was only approximately 35% of the value of the property; the "rental" payment of $190,000 constituted approximately 250% of the purchase price stated in the option; and the total annual "rental" payments were in excess of 70% of the total consideration passing to the appellees.

The 9th Circuit, in the *Haggard* case, said that "the purpose of the contracts was clear, and, therefore, the tax consequences are well settled."

The Courts have held that an instrument is a lease or a sale depending upon whether the parties intend the payments to be made for the use of the property alone, or for title to the property as well as its use during the payment period. If the intention of the parties is merely to enable the payer to use the property, their agreement is a lease. On the other hand if their intention is to enable the payee to use and also to acquire or purchase the property, their agreement is a sale. *E. G. Robertson,* 19 B. T. A. 534, 540 (1930). *Smith v. Commissioner, supra; Taft v. Commissioner, supra; Helser Machine & Marine*

Works, Inc. v. Commissioner, supra; Judson Mills v. Commissioner, supra; Truman Bowen v. Commissioner, supra; Chicago Stoker Corp v. Commissioner, supra; Jefferson Gas Coal Co. v. Commissioner, 52 F. 2d 120 (3rd Cir. 1931).

> "A lease contemplates only the use of the property for a limited time and the return of it to the lessor at the expiration of that time; whereas a conditional sale contemplates the ultimate ownership of the property by the buyer, together with the use of it in the meantime." *In re Rainey,* 31 F. 2d 197 (Dist. Md. 1929).

It is therefore clear, under the facts of these cases and the case law applicable thereto, and in particular under the decisions of the 9th Court of Appeals, that Buttrey Co. intended to and did acquire title to property by making 10 yearly payments each in the amount of $19,000 or a total of $190,000 and by making a final payment of $75,00 on November 5, 1955, at which time the deed, abstract, and title opinion rendered as of January 14, 1946 were delivered to Buttrey Co. by the escrowee who was paid its fee by Buttrey Co. It is likewise clear that the appellees intended to and did sell the property under a sales agreement in consideration for the ten annual payments totaling $190,000 plus the final payment of $75,000.

5. *ANSWER TO ARGUMENT OF APPELLANT IN HIS BRIEF.*

Appellant claims the District Court erred in holding that the appellees sold the property to Buttrey Co. Appellant's argument on this point is not extensive (Appellant's Brief, pages 36-40) and seems to be more in the nature of a technical objection to paragraph number 16 of the District Court's Findings of Fact (No. 15983, R. 86). Appellant states that the question is not one of pure fact and that it is at least a mixed question of law and fact. It is submitted that in addition to the factual quesions, the District Court was well aware of the legal questions and that so far as the ultimate question being a mixed question of fact and law, the District Court's Opinion (No. 15983, R. 73-79) fully discusses the applicable case law as interpreted by the 9th Court of Appeals, and after so doing, the Court appropriately held in the appellees' favor. In addition to paragraph 16 of the Findings of Fact, the Court, in its Conclusions of Law, found that the agreement constituted a sales agreement (No. 15983, R. 88). There is no need to quote at great length from the Court's Opinion, its Findings of Facts and Conclusions of Law. It is submitted that the District Court, which sat as both the trier of the facts and of the law, did not err in either its factual or legal conclusion and it is further submitted that the decision of the District Court must be affirmed.

STATEMENT OF FACTS RELATING TO THE PROCEDURAL QUESTIONS RAISED BY THE APPELLANT.

The appellant has raised two procedural questions, one involving Section 44 of the Internal Revenue Code of 1939 and the other involving a question of "fatal variance" between certain of the refund claims and the complaints. The facts, insofar as they relate to these issues, are contained in the complaints, in the answers, in the Stipulation of Facts entered into by the parties, and in the oral testimony.

It is noted that both of these issues were raised in the District Court and were rejected by the District Court in Paragraph 18 of its Finding of Fact (No. 15983, R. 87, 88) and in Paragraph 4 of its Conclusions of Law (No. 15983, R. 88).

1. *Facts relating to Section 44 of the 1939 Internal Revenue Code.*

On page 4 of his brief, appellant raises the question of whether the taxpayers may avail themselves of the installment sales provision of the statute (Section 44 of the 1939 Internal Revenue Code) by filing refund claims and bringing suit on that basis for recovery of a part of the taxes paid.

At the outset, appellees emphatically deny that their complaints and law suits are based on Section 44 of the 1939 Internal Revenue Code and they further deny that the District Court in its Opinion and in its Findings of Fact and Conclusions of Law ever referred to Section 44 or in any way based its decision and judgments upon Section 44 of the 1939 Code. The appellees, in their complaints, during the trial, and in their briefs have never attempted to come within the provisions of Section 44.

Appellant, in his statement of facts contained on pages 5 through 13 of his brief, does not set forth any facts which would lead to the conclusion that the taxpayers are trying to avail themselves of Section 44 of the 1939 Code. It is true that the original refund claims of the years 1946, 1947, 1948, and 1949 for both taxpayers and William G. Elliot for 1950, were based on the ground that the transaction evidenced by the "Lease Agreement and Purchase Option" and the "Memorandum Agreement," constituted a conditional sale of the Buffalo Block property resulting in a capital gain and it is true that said refund claims did include the legal theory that Section 44 was applicable. The supplemental refund claims filed by both taxpayers for 1949 and by William G. Elliot for 1950 and all of the refund claims for later years contained no reference to Section 44 and none of them was based on the legal theory that Section 44 was applicable.

In the paragraph commencing in the middle of page 13 of Appellant's brief, two assumptions are made, neither of which is supported by the facts. Appellant states that the complaints are based on the ground that Section 44 is applicable and that the court's opinion, finding of fact and conclusions of law, and judgments are based on the ground that Section 44 is applicable. It is submitted that neither of these assumptions is correct.

Regarding the complaints (No. 15983, R. 3-12; No. 15984, R. 3-13), it is emphasized that neither of them makes any reference whatsoever to Section 44 nor are they in any way based on the legal theory that Section 44 is applicable in these cases.

In paragraph number (4) of both complaints (No.

15983, R. 3, 4; No. 15984, R. 4) it is provided that these actions arise under Section 117 of the Internal Revenue Code of 1939. In paragraphs numbered (22) through (35) in William G. Elliot's complaint (No. 15983, R. 8-11) and paragraph numbers (22) through (37) in Thomas W. Elliot's complaint, (No. 15984, R. 7-11) certain facts are set forth giving rise to the appellees' causes of action and throughout these paragraphs, it is alleged that the transfer of real property resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939 and once again it is emphasized that no allegation or claim was made that Section 44 was or is applicable.

Regarding the court's opinion, findings of fact and conclusions of law, and judgments, the appellant also is in error in stating or inferring that they are based on the ground that Section 44 is applicable.

Counsel for the respective parties in the Stipulation of Facts entered into in both cases (No. 15983, R. 72; No. 15984, R. 51) agreed in paragraph number 23 of the stipulations that if the court held that the agreements in question constituted a sale or conditional sales agreement, then in order to conserve the time of the district court, the parties would submit computations of amounts of overpayments to be entered as judgments, and if the computations differed, the parties would be heard on that matter. Therefore, in view of this stipulation, it was only necessary in the first instance for the Court to determine if the agreements did effect a sales agreement or a true lease agreement. If the Court so held, the question of their computing the correct overpayment was to be later considered. The Court did, of course, hold that they constituted a sales agreement as distinguished from a lease agreement. In the concluding paragraph of the Opinion (No. 15983, R. 79), the Court called attention of counsel to the stipulation of facts in both cases and particularly to paragraph number 23 of the stipulations which the Court had previously referred to in its Opinion (No. 15983, R. 74). There is absolutely nothing contained in the Court's Opinion stating that Section 44 was applicable in these cases and therefore the appellant is incorrect in so stating.

The Court's Opinion was filed on June 27, 1957 (No. 15983, R. 79) and thereafter, under date of October 31, 1957, counsel for the respective parties in pursuance of the Court's Opinion and also pursuant to paragraph number 23 of the stipulation of fact, entered into a stipulation (No. 15983, R. 91, 92) whereby it was provided that, for the purpose of these actions, the parties agreed upon certain amounts of overpayments by the appellees. It was agreed by counsel that these amounts did not bind either party to any particular legal theory or method of computing the overpayments. The agreement was entered into as a convenience for both parties and for the Court in that it was then no longer necessary to hold a court hearing on the matter of computing the overpayments. After this stipulation was filed, the Court then made and filed its Findings of Fact and Conclusions of Law on

October 31, 1957 (No. 15983, R. 81-88), and Judgments were entered on the same date (No. 15983, R. 89, 90; No. 15984, R. 54, 55). The Court incorporated the stipulation of overpayments into its Findings of Fact and in paragraph 17 thereof the correct amounts of overpayments were deemed to be those contained in the stipulation.

Concerning the Findings of Fact, there is no statement that the Court found Section 44 of the 1939 Code to be applicable and no reference is made to it whatsoever. The Court did find, in paragraph number 18 (No. 15983, R. 87), that the appellees were entitled to the refunds of the amounts agreed upon and further found that there was no fatal variance involved in these cases and that there is no procedural or substantive rule of law which prohibits the making of the refunds. In its Conclusions of Law, the Court in no way stated or inferred that Section 44 was applicable in this case (No. 15983, R. 88). The Court did conclude that the property had been sold and that the installment payments made pursuant to the agreements were subject to long-term capital gain treatment under Section 117 of the 1939 Code and that the appellees were entitled to refund of tax overpayments, the amounts of which were agreed upon in the stipulation made by the parties. Neither do the Judgments in any way refer to Section 44 (No. 15983, R. 89, 90; No. 15984, R. 54, 55). Therefore, the appellant is in error as a matter of fact in his statement that the Court's Findings of Fact, Conclusion of Law, and Judgment are based or grounded on

Section 44.

2. *Facts relating to the alleged "fatal variance" between certain of the refund claims and the complaints.*

The appellant has raised the question on page 4 of his brief as to whether, as to some of the latter years involved, the District Court may entertain suits for recovery based on the ground that the taxpayers were entitled to have their taxes computed under the method set forth in Section 44 whereas the refund claims for those years were based on the ground that gain from the sale was taxable in the year of sale.

To some extent, this issue is tied in with the other procedural question raised by the appellant but nevertheless it is a separate question.

In the appellant's statement of facts contained on pages 5-13 of his brief, he attempts to cover the facts involved in this question on page 12 and 13. However, said statement of facts contains several errors. On page 13, he states that the complaints and the opinion, findings of fact and conclusions of law, and judgment are based on the grounds that the appellees are entitled to report their long-term capital gain on the installment basis contained in Section 44 of the Internal Revenue Code. This is not correct (See *supra,* pages 50 to 55).

It is submitted that no "fatal variance" exists between the refund claims and the complaints and the decision of the District Court. The District Court, in paragraph number 18 of its Findings of Fact (No. 15983, R. 87) found that there was no "fatal variance" between the refund claims and the complaints and the Court further found that no procedural or substantive rule of law prohibited the making of the refund. In its Conclusions of Law (No. 15983, R. 88), the Court held that there was no procedural or substantive rule of law which prohibited judgments from being entered for the refunding of the overpayments.

The original refund claims for 1946, 1947, 1948, and 1949 for both appellees and the original 1950 refund claim for William G. Elliot were filed by the appellees after consultation with an accountant in Billings, Montana. The grounds for these refund claims was that the amounts which had been paid to the appellees during those years under the agreement with Buttrey Co. constituted proceeds from the sale of property subject to long term capital gain taxation rather than rental income. These claims contained the legal theory that Section 44 of the Internal Revenue Code was applicable.

The appellees acknowledge, just as they did in the District Court, that the above refund claims were based on an incorrect legal theory and no attempt was made in the District Court nor is it made herein to have their long-term capital gain computed under Section 44 of the 1939 Internal Revenue Code.

Supplemental refund claims were prepared and filed for the year 1949 by both appellees and in said claims, the appellees abandoned the legal theory that Section 44 was applicable and instead asserted the legal theory that they were entitled to exclude all payments received by them in 1949 under the agreement with Buttrey Co. Larger amounts of refunds were claimed in the supplemental claims. At the time that said supplemental refund claims were filed for 1949, the statute of limitations for filing refund claims for all of the earlier years had expired. Hence, the appellees were precluded from demanding larger refunds for these years by filing amended refund claims.

The second refund claim filed by William G. Elliot for 1950 and all of the refund claims filed by both appellees for 1951, 1952, and 1953 were based on the legal theory that a completed sale occurred in 1946 resulting in a long-term capital gain, but no claim was made that Section 44 of the 1939 Code was applicable.

It is emphasized that in all of the refund claims involved in these cases that the factual grounds for the refunds were all the same. That is, the factual grounds were and are that the payments received under the agreements with Buttrey Co. constitute sales proceeds and are subject to long-term capital gain treatment. It is true that so far as the *legal theory for computing the taxable gain* is concerned, the latter refund claims do advance a different theory or method. However, so far as the *facts* giving rise to a refund claim or cause of action is concerned, there is no variance and the same basic facts giving rise to a cause of action are contained in all of the refund claims.

The facts which are contained in the refund claims are exactly the same facts upon which the appellees' causes of action are predicated in their complaints and upon which the trial court held in the appellees' favor. Hence, there could be no "fatal variance" which would preclude the appellees from recovering any of the overpayment for any of the years for which judgments were rendered by the District Court.

ARGUMENTS

1. *The District Court's decision is not based on Section 44 of the 1939 Internal Revenue Code.*

The appellant states on page 14 of his brief that the taxpayers are not entitled to recover in this case on the installment basis of reporting income as provided for in Section 44 of the 1939 Internal Revenue Code and that the District Court erred in entering judgments for the taxpayers on that ground.

This "issue" seems to be an entirely factual one and the appellees will not herein discuss the court cases and other authorities cited by the appellant since they at best raise only moot questions. Appellees deny that the District Court entered judgments based on Section 44 of the 1939 Code. As stated above on pages 50 to 55, there is no reference whatsoever to Section 44 in the complaints or in the District Court's Opinion, Findings of Fact or Conclusions of Law. We will not repeat all of the facts stated above. It seems clear, as a matter of fact, that the District Court did not base its decision on Section 44 of the 1939 Code and therefore the appellant cannot prevail on this "issue."

It is noteworthy that in appellant's argument on this "issue", contained on page 18 to 32, that whereas an extensive legal argument is presented, no facts are stated which would bring those legal arguments into play. Nor does the appellant state any facts about this "issue" in his Statement of the case appearing on page 5 through 13 of his brief.

Since the appellant has stated no facts which would warrant the raising of this "issue" and since the facts contained herein clearly demonstrate that the District Court did not apply Section 44 of the 1939 Code, it is submitted that as to this "issue" the appellant's appeal must fail and the judgments must be affirmed.

2. *The District Court correctly held that no "fatal variance" was involved in these cases.*

Appellant claims the District Court erred in failing to hold that as to the years 1951, 1952, and 1953 as to taxpayer William G. Elliot and as to the years 1950, 1951, 1952, and 1953 as to taxpayer Thomas W. Elliot, that there was a "fatal variance" between the complaints and the refund claims for those years (Appellant's brief, p. 14). On page 16 of his brief, appellant states that the refund claims for the above years were based on the ground that a completed sale occurred in 1946 while both the complaints and the judgments of the District Court were based on the grounds that the sale was taxable pursuant to Section 44 of the 1939 Internal Revenue Code.

It does not seem necessary to discuss all of the material contained on pages 32-36 of appellant's brief because this "issue", somewhat similar to the preceding "issues", is simply a moot question because the complaints and also the judgments in these cases are *not* based on Section 44 of the 1939 Code. See above at pages 50 to 55 and pages 58-59.

The appellant cannot prevail on this "issue" because he has assumed an incorrect set of facts. That is, neither the complaints nor the District Court's decision are based on Section 44 of the 1939 Code. A full discussion of the legal authorities is therefore unnecessary but the appellees do want to point out that the reason behind requiring a taxpayer to base his complaint on the same grounds as those contained in his refund claim, is to avoid requiring the taxing authorities to investigate the *fact* situation contained in a refund claim and later be faced with a different *fact* situation in dealing with a refund suit which would necessitate a second factual investigation. Hence, the rule prevents a taxpayer from alleging one set of *facts* in a refund claim and then coming along later and suing on a different set of *facts*. It has never been held that a variance in *legal theories* between a refund claim and a complaint is such a "fatal variance" as to preclude a recovery.

The cases cited by the appellant on pages 33 to 36 of his brief, and particularly the decisions of this Court which are listed therein, clearly state that in order for the "fatal variance" doctrine to be applicable there must be a fatal variance between the *facts* alleged in the refund claim and the *facts* alleged in a taxpayer's complaint.

This is also the rule enunciated in *United States v. Andrews,* 302 U. S. 517, wherein the Supreme Court held an "amended" claim was invalid where it contained a different *factual* grounds for recovery. However, the Supreme Court indicated that an amended claim based on the same facts, but utilizing a different legal theory or grounds, was a valid amendment.

In *Warner v. Walsh,* 24 F. 2d 449 (D. C. Conn. 1927), the Commissioner of Internal Revenue contended that the lagal theory relied on by the taxpayer was not set forth in the refund claim and therefore the taxpayer should be barred from recovering a tax overpayment. The Court said that the Commissioner was apprised of all of the material facts which were contained in the refund claim and the Court further stated:

> "It is true that the *theory* of the relief is not set out. But the *theory* of a claim for relief is something separate and apart from the facts, and the same set of facts may, and often does, give rise to differing theories. To say that an argument may not be advanced in this court which was not elaborated in notice of claim before the Commissioner is unwarranted by the language and intent of the statute under consideration."

In *Wunderle v. McCaughn,* 38 F. 2d 258 (D. C. Pa. 1929), the *facts* contained in the refund claim were the same as those alleged in the complaint and presented at the trial. However, in the refund claim, a legal theory was set forth to the effect that a deduction was allowable because a bad debt had been incurred, whereas, the taxpayer later argued that the deduction was in the nature of additional compensation rather than a bad debt. The

Court held that a claim for refund which sets forth all of the facts giving rise to a claim is sufficient compliance with the statute, and, further, the fact that an erroneous legal theory is presented does not destroy the legal sufficiency of the claim for refund. The Court further said that where the Commissioner of Internal Revenue is apprised of all of the material facts, it is immaterial that the theory on which relief is asked is not set out nor is it material that a wrong theory is set forth in the refund claim.

It is submitted that all of the refund claims filed in these cases are based on the same basic *facts,* that is, that the "Lease Agreement and Purchase Option" and the "Memorandum Agreement" constitute a sales agreement rather than a true lease. Only one investigation by the Internal Revenue Service was required and that investigation concerned whether or not the agreements constituted a sales agreement or a true lease agreement. It is granted that the refund claims for the earlier years, which were prepared by the taxpayers' accountant, did contain the *legal theory* that the gain on the sale should be computed and taxed pursuant to Section 44 of the 1939 Code. The latter refund claims abandoned this *legal theory* but the same basic facts were alleged therein and also in the complaints.

In the Prayer of both complaints, (paragraph (36) of No. 15983 and Paragraph (38) of No. 15984), certain figures are set forth which are based on the theory that a completed sale occurred in 1946 and no reference is made to Section 44. The amounts prayed for relating to the refund claims for the latter years are not connected in any way to Section 44. It is true that for some of the earlier years the amounts demanded are the same or similar to the amounts asked for in the refund claims wherein Section 44 was erroneously referred to and applied by the accountant who prepared those refund claims. However, the reason for the similarity of the amounts is not due to any contentions by the appellees that Section 44 is applicable but rather to the general rule that a taxpayer cannot sue for a refund in a greater amount than that demanded in his refund claim. It is the general practice today for the refund claim draftsman to insert, after a demand for a certain amount of dollars, the words "or such greater amount as is legally refundable". In such case, a larger amount can be asked for in the prayer in a complaint. *Woolworth & Co., v. U. S.*, 91 F. 2d 973. However, no qualifying words were added after the specific dollar amounts requested by the taxpayers herein and therefore in the complaints only the dollar amounts asked for in the refund claims were demanded.

It is further submitted that the amounts asked for in the Prayer to the complaints do not, in themselves, give rise to any particular substantive legal theory of law nor should they be considered out of context with all of the other allegations contained in the complaints. The amounts asked for in the Prayer depend upon many factors relating to both the merits and procedural aspects of the case and also to many technicalities. In addition, it is universally recognized that an amount asked for in a prayer to a complaint does not constitute a part of the facts giving rise to a cause of action.

It is also noted that the stipulation of amounts deemed to be the correct overpayments in these cases made it unnecessary for the District Court to decide whether or not the full capital gain was taxable in 1946 or whether the taxpayers would first be allowed to recover their adjusted cost basis of the property and thereafter each yearly payment received would be included as a capital gain in their tax returns for the years of receipt.

Since the appellant has stated no facts which would warrant the raising of this "issue" and that in any event no "fatal variance" in involved, it is submitted that as to this "issue" the appellant must fail and the judgments must be affirmed.

CONCLUSION

Under the record in this proceeding, the exhibits, the stipulation agreements between the parties, and the law pertinent to these cases, the judgments must be affirmed. The District Court did not err and certainly no reversible error was committed.

Respectfully submitted,

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By..

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